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SUBJECT: CHEVRON RUSSIA PRESIDENT ON CPC BREAKTHROUGH,
COMPANY,S PLANS IN RUSSIA, TURKMENISTAN

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projects. He also said Chevron is hoping to develop oil and gas fields in Turkmenistan and is pursuing a JV with Gazpromneft, Gazprom,s oil subsidiary. End Summary.

CPC BREAKTHROUGH

¶12. (C) MacDonald told us August 20 that after years of stalled negotiations (ref B) to alter the financial position of the CPC, the recent shareholders meeting in Astana over the previous two days had resulted in a reduction in the interest rate on the CPC's \$5.5 billion (and growing) debt from 12.66% to 6% and a temporary tariff increase from \$31 to \$38 per ton.

¶13. (C) MacDonald said these two changes would improve CPC's finances by nearly \$600 million per year -- turning a current loss of approximately \$240 million per year into a profit of approximately \$340 million in the first year. This would allow CPC to begin to pay down its debt, to pay royalties to shareholders (including the GOR), and to pay taxes to the GOR on the new profits.

¶14. (C) MacDonald said ExxonMobil had been the shareholder preventing an earlier deal of this sort. They had been reluctant to alter the original contract, both because ExxonMobil is also facing pressure to renegotiate its Sakhalin 1 project (ref A) and because it wanted to maintain its reputation for insisting on contract sanctity.

CPC EXPANSION

¶15. (C) According to MacDonald, the deal should set the stage for CPC,s long-delayed expansion. The Russian government had previously blocked expansion of the CPC (the only oil pipeline in Russia not controlled by state-owned monopoly Transneft), complaining that it mainly shipped Kazakh oil and was not sufficiently profitable to Russia, concerns which the new arrangements went a long way to alleviating. MacDonald added that the interest rate and tariff reductions would expire after one year if the GOR and the government of Kazakhstan do not reach agreement on CPC expansion.

¶ 6. (C) McDonald added that CPC expansion was, however, still dependent on agreement on the BAP. Chevron strongly supports the BAP, which would bypass the Bosphorus and transport Russian and Kazakh oil through Bulgaria and on to consumers. MacDonald said Chevron's interest in CPC had always been expanding the pipeline to ship the growing volumes of oil from its Tengiz field in Kazakhstan, which, according to MacDonald, is set to double production. He expressed optimism that by 2014 the CPC would be carrying up to 68 million tons of oil per year (up from the current 33), that it would be debt-free, and that it would be "making a fortune" for its owners.

TURKMENISTAN

¶ 7. (C) MacDonald said he had just returned from a trip to Ashgabat, where he had been positively received by Deputy Prime Minister Tagiev and the Executive Director of the State Agency for the Management and Use of Hydrocarbons, Bairamurat Muradov. He said Chevron was negotiating a lease on an office in Ashgabat, which it intended to staff with an expat. The company was interested in developing the off-shore Serdar oil field, which lies in disputed waters. Chevron hoped its involvement could resolve the dispute and lead to a production sharing arrangement between Turkmenistan and Azerbaijan.

¶ 8. (C) MacDonald said the company was also interested in developing gas deposits in Turkmenistan's vast Amu Darya Basin. Turkmenistan had been impressed with Chevron's technology and was interested in working with Chevron to develop the gas fields but remained wary of Russian reaction to its partnering with an American firm. He said Turkmenistan had the potential to meet its contractual commitments to Russia and China and pursue a third export route to the West. MacDonald said in his view, developing upstream capacity in Turkmenistan would inevitably lead to new export pipelines rather than the reverse.

GAZPROM

¶ 9. (C) MacDonald called Gazprom a problem, describing it as an unstable company run by politicians. Rosneft and Lukoil by contrast are run by competent technocrats. He said Gazprom's proposal to major international companies to join in the development of the giant Shtokman gas field had been completely unattractive, which is why Chevron decided in May that it would not participate. A company would have to & sink billions into a Shtokman, hoping they won't screw you in the revenue phase."

¶ 10. (C) MacDonald added, however, that Chevron is in the closing phase of negotiations on a JV with Gazpromneft (Gazprom's oil subsidiary) to develop some small fields. He said Chevron's initial investment would only be in the \$200-300 million range, not much to lose if things went south, and that if all went as planned, production revenues would ramp up quickly.

COMMENT

¶ 11. (C) The CPC breakthrough is potentially very good news. CPC expansion should bring more Kazakh and Russian oil to the market. It will also further entangle Russia in global energy markets through a mutually advantageous and profitable venture. Since BAP expansion is a condition of CPC expansion, the deal on the CPC should add pressure on BAP parties to move forward quickly. In Turkmenistan, Chevron is one of many firms looking to plant roots and it remains to be seen whether it can broker an agreement on Serdar or gain a foothold in the gas sector. End Comment.

Russell